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No. 96-1580

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

EDWARD A. SHAY, *et al.*,
Petitioners,

v.

NEWMAN HOWARD, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF *AMICUS CURIAE* AMERICAN ACADEMY OF ACTUARIES IN SUPPORT OF PETITIONERS

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The American Academy of Actuaries (the "Academy") hereby moves the Court for leave to submit this brief as *amicus curiae*, pursuant to Rule 37 of the Rules of the Supreme Court of the United States, in support of the petition for certiorari in No. 96-1580. The petitioners have consented to the filing of this brief, as is demonstrated by the accompanying letter of consent from petitioners' counsel. Respondents have refused consent.

The Academy is a nonprofit professional association of approximately 13,000 actuaries of all specialties (health, life, pension and property-casualty) practicing in the United States. Many of the Academy's member actuaries work closely with plan fiduciaries to provide professional services to ERISA plans. The appellate court's analysis in

this case has the potential to significantly limit fiduciaries' ability to rely upon the expert advice they receive from actuaries and other service providers, undercutting the value of the expert services that actuaries provide to ERISA plans. Such a result could be severely harmful to practicing pension actuaries and, therefore, the Academy has a substantial interest in that aspect of this case.

Additionally, many of the Academy's members practice as expert witnesses, providing actuarial testimony to courts, administrative bodies, and legislators. The appellate court's rejection of the valuation techniques used in this case was apparently based upon its own independent evaluation of those techniques, and not upon expert testimony offered at trial. Unless this aspect of the appellate court's decision is addressed by the Court, a precedent will be established that any appellate court may, on its own initiative, independently declare expert testimony and techniques invalid. Such a result would inevitably devalue expert testimony, bringing severe injury to the Academy's members who practice as expert witnesses. The Academy, therefore, has a substantial interest in this aspect of the case as well.

The Academy is, moreover, well positioned to advise the Court on the potential consequences of the appellate court's decision for actuaries and others who provide professional services to ERISA plans and expert testimony in judicial, legislative, and regulatory proceedings. Although the petition for certiorari and respondents' opposition to the petition dealt at some length with the particulars of the appellate court's decision and its effect upon the individual parties to the case, we do not believe that the broader implications of the appellate court's decision have yet been fully addressed. The Academy respectfully requests the opportunity to share with the Court its concerns regarding the potential impact of this case on ERISA service providers and expert witnesses.

The Academy's brief is short, and addresses only those aspects of the case that are of importance to our members and within the scope of our expertise. Further, we observe that respondents have lodged two *amicus curiae* briefs in support of their own position while refusing consent to the filing of this or (we understand) any other *amicus curiae* brief in support of the petition for certiorari. If the Court is going to have the benefit of the views expressed in those briefs, we believe that the Court should also have access to the information that can be provided by the Academy in support of the petition for certiorari.

For the foregoing reasons, we respectfully request that this motion for leave to file the Academy's *amicus curiae* brief be granted.

Respectfully submitted,

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May 7, 1997

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BRIEF OF *AMICUS CURIAE* AMERICAN ACADEMY OF ACTUARIES IN SUPPORT OF PETITIONERS

The American Academy of Actuaries submits this brief as *amicus curiae*, pursuant to Rule 37 of the Rules of the Supreme Court of the United States, in support of the petition for certiorari in No. 96-1580.

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The American Academy of Actuaries (the "Academy") is a nonprofit professional association established in 1965 to provide a common membership organization for actuaries of all specialties (health, life, pension and property-casualty) practicing in the United States. To become an Academy member, an actuary must satisfy rigorous edu-

cation and experience requirements. Membership in the Academy is a prerequisite in many states for actuaries to be eligible to perform certain statutorily-required professional services. The Academy's membership is approximately 13,000 actuaries nationwide.

The Academy regularly provides unbiased expertise to state legislatures, regulators, and Congress on the actuarial implications of laws and regulations involving insurance, health care and retirement income security.[1] The Academy also participates as an *amicus curiae* in court cases with significant actuarial implications. For example, in 1995 the Academy joined with the American Society of Pension Actuaries in submitting an *amicus curiae* brief in support of the petitioners in *Lockheed Corporation v. Spink*, —— U.S. ——, 116 S. Ct. 1783 (1996) ("*Lockheed*"). Similarly, in 1992, the Academy submitted an *amicus curiae* brief in support of the respondents in *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993) ("*Mertens*").

As we previously advised the Court in *Lockheed* and *Mertens*, the Academy's many members who provide professional services to ERISA plans "work closely with plan fiduciaries," and are significantly affected by the Court's rulings on the relationship and respective liabilities between fiduciaries and the non-fiduciary experts who provide professional services to ERISA plans. The appellate court's analysis here has the potential severely to limit fiduciaries' ability to rely upon the expert advice they receive from actuaries and other service providers. If left unaddressed, the appellate court's reasoning may undercut

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[1] For example, the Academy recently testified on Capitol Hill concerning development of a network of private insurance to supplement Medicare. "Provider Network Bill Sponsors Seek Middle Ground on Solvency, Regulation," *BNA's Daily Report for Executives* (March 20, 1997). The Academy also recently participated in a forum on Social Security reform sponsored by Senator Ben Campbell of Colorado. "Panelists Say No Easy Social Security Solutions," *Northern Wyoming Daily News* (March 26, 1997).

the value of the expert services that Academy members provide to ERISA plans.

Further, many of the Academy's members practice as expert witnesses, providing actuarial testimony to courts, administrative bodies, and legislators.[2] The appellate court's rejection of the valuation techniques used in this case was apparently based upon its own independent evaluation of those techniques, and not upon other expert testimony offered. Moreover, the appellate court did not rule that the trial court's findings of fact were "clearly erroneous," a fundamental requirement if an appellate court reverses a trial court's factual findings. Unless this aspect of the appellate court's decision is overturned by the Court, a precedent will be established that any appellate court may, on its own initiative, independently declare expert testimony and techniques invalid. Such a result would substantially devalue expert testimony, bringing severe injury to the Academy's members who practice as expert witness.

For these reasons, the Academy has a substantial interest in this case.

SUMMARY OF ARGUMENT

The appellate court's decision in this case does not merely require ERISA fiduciaries who engage in self-dealing transactions to retain the services of outside experts, provide those experts with all relevant, material information, and refrain from providing any false or misleading information. The appellate court also requires the fiduciary to "question" the expert's conclusion and, in

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[2] Indeed, so many of the Academy's members practice as expert witnesses that the Actuarial Standards Board, a committee created by the Academy's bylaws to promulgate standards of practice for actuaries practicing in the United States, has seen fit to issue Actuarial Standard of Practice No. 17, "Expert Tetimony." This standard offers guidance to actuaries who practice as expert witnesses.

some unspecified circumstances, to "retain a second firm to review it." This requirement goes beyond the scope of fiduciaries' responsibilities as described by other federal appellate courts, and essentially calls for the fiduciary to become almost as expert as the professional from whom the fiduciary seeks advice. Fiduciaries who seek to satisfy the appellate court's requirements are likely to feel decreasingly able to rely on the opinions and recommendations of their expert service providers, and may well feel increasingly obliged to retain a second opinion whenever the fiduciary believes that an outside party could find some reason to question the expert's conclusions. Such a trend could result in the devaluation of expert services to ERISA plans, and increase the costs of administration of those plans, to the ultimate detriment of the plan participants.

Further, the appellate court rejected the techniques and assumptions used by the valuation expert in this case without either finding that the appellate court's factual conclusions were clearly erroneous or relying upon other expert testimony provided below. It appears that the appellate court simply determined on its own that the valuation was unsatisfactory, a determination that exceeded the scope of the court's appellate review function. Unless this aspect of the appellate court's decision is reversed, a precedent will be set permitting an appellate court summarily to reject expert testimony on its own initiative. Such a precedent would significantly decrease the value of expert testimony, and could cause substantial harm to the judicial process.

ARGUMENT

I. THE APPELLATE COURT'S DECISION MAY PREVENT FIDUCIARIES FROM RELYING IN GOOD FAITH UPON THE ADVICE OF EXPERTS WHO PROVIDE PROFESSIONAL SERVICES TO ERISA PLANS.

The Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1101 *et seq.* ("ERISA"), prohibits the fiduciaries of an employee stock ownership plan ("ESOP") from engaging in self-dealing transactions with the plan. 29 U.S.C. § 1106. ERISA also contains an exception to this prohibition for the purchase or sale by a plan of qualifying employer securities if, among other things, the transaction is for "adequate consideration." 29 U.S.C. § 1108(e). It is the statutory requirement for adequate consideration that is at issue in this case.

The fiduciaries for an ESOP operated by the Pacific Architects and Engineers, Inc. ("PAE") agreed to sell PAE stock owned by the ESOP to a trust created by Edward A. Shay, a plan fiduciary. The fiduciaries hired Arthur Young & Company ("Arthur Young") to perform a valuation of the stock, and sold the stock at the price determined by Arthur Young to be fair market value.[3] The plan participants and beneficiaries sued the fiduciaries, arguing that they had breached their ERISA obligations by selling the stock for less than adequate consideration.

After a six-week bench trial, the district court found that the ESOP fiduciaries had acted appropriately in selecting Arthur Young, had provided Arthur Young with all the relevant, material information required to properly conduct the valuation, and did not provide any false or misleading information. The district court did not find that the fiduciaries had any knowledge to con-

[3] The Academy takes no position concerning the appropriateness of the valuation methods used by Arthur Young in this case.

tradict or reason to question Arthur Young's valuation. The district court also found that the price set by Arthur Young constituted "full, fair, and adequate consideration" for the stock, and that the fiduciaries had not, therefore, breached their duties under ERISA.

The appellate court disagreed, finding that the ESOP fiduciaries had not acted with sufficient prudence. Criticizing Arthur Young's valuation, the court concluded that the fiduciaries should have determined that reliance on Arthur Young's valuation was not "reasonable under the circumstances." The appellate court further stated that the fiduciaries should have "question[ed] the valuation or retain[ed] a second firm to review it." *Howard v. Shay*, 100 F.3d 1484, 1489 (9th Cir. 1996). The court then declined to uphold the trial court's ruling that the fiduciaries had fulfilled their ERISA duties. *Id.* at 1490.

The appellate court's decision is inconsistent with the leading First Circuit case that addresses this issue, *Donovan v. Cunningham*, 715 F.2d 1455 (5th Cir. 1983). In *Cunningham*, the court specifically held that ERISA fiduciaries "need not become experts in the valuation of closely-held stock," but need only provide complete and up-to-date information to an expert and cease to rely upon that expert's opinion when the fiduciary knows the opinion is based on obsolete information. *Id.* at 1474 (citations omitted).[4]

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[4] The Seventh Circuit Court of Appeals set forth a similar analysis in *Eyler v. Commissioner of Internal Revenue*, 88 F.3d 445 (7th Cir. 1996). In *Eyler*, the court found that plan fiduciaries could not meet their ERISA obligations solely by relying on their attorney's representation that a self-dealing transaction met the requirements of ERISA, but observed that "there is no evidence that the law firm performed a valuation analysis or that the firm purported to possess particular expertise in valuing stock." *Id.* at 456. Thus, *Eyler* suggests that, had the fiduciaries relied upon a current valuation analysis from a qualified expert, their ERISA obligations might well have been satisfied.

As the dissent below observed, "the majority cites [*Cunningham*] to support the creation of a new and unwarranted requirement for ERISA fiduciaries who would obtain expert opinions—that fiduciaries must make certain that reliance on an expert's advice is reasonably justified under the circumstances. *Cunningham* simply does not stand for that proposition." *Howard,* 100 F.3d at 1490. The Academy agrees that the appellate court's additional requirement is unwarranted. As the courts have observed, the valuation of closely-held stock is a difficult task for which "the opinions of experts are peculiarly appropriate." *Central Trust Company v. United States,* 305 F.2d 393, 399 (U.S. Ct. of Claims 1962), *citing Bader v. United States,* 172 F. Supp. 83 (D.C. S.D. Ill. 1959). Requiring ERISA fiduciaries to recognize when they may rely upon an expert's advice and when they must question that advice or seek a second opinion can force the fiduciary to possess or acquire tremendous expertise. This requirement is inconsistent with Congress' intent in ERISA "not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place." *Varity Corporation v. Howe,* —— U.S. ——, 116 S. Ct. 1065, 1070 (1996). It may also be inconsistent with the skills of many fiduciaries.

In our experience, fiduciaries vary widely in their understanding of valuation techniques. Less sophisticated fiduciaries must rely on actuaries and other experts properly to value plan assets and liabilities. Those fiduciaries are unlikely to be able to comply easily with the appellate court's new requirements, and may fear substantial personal liability if they fail to obtain a second opinion on every piece of expert advice they receive. Such an outcome would increase plan's administrative costs, and would make it more difficult for actuaries and other professional service providers to work with fiduciaries in an atmosphere of mutual confidence.

As the appellate court observed, "a fiduciary who is determined to self deal has ample opportunity to sway the final valuation that will set the transaction price . . . either in selecting of the expert or by limiting the information conveyed to the expert." *Howard,* 100 F.3d at 1490. Where, as the trial court found here, the fiduciary properly selects the expert and conveys to the expert all relevant, material information, the fiduciary should be permitted to rely in good faith on the expert's opinion unless the fiduciary knows or has reason to know that opinion to be flawed. We urge the Court to grant certiorari to rectify this aspect of the decision below.

II. THE APPELLATE COURT ERRED IN INDEPENDENTLY REJECTING ARTHUR YOUNG'S EXPERT TESTIMONY.

Much of the appellate court's decision focuses on perceived flaws in the valuation techniques and assumptions used by Arthur Young to value the PAE ESOP stock. Indeed, the appellate court found the valuation to be so manifestly flawed that "[e]ven a cursory review of the Arthur Young valuation and fairness opinion reveals the carelessness" of the fiduciaries' reliance. *Howard,* 100 F.3d at 1489. The appellate court, however, never cited any expert authority to support its criticisms of the Arthur Young valuation. Moreover, the appellate court never found the trial court's holdings, that the discounts applied by Arthur Young were appropriate and that the valuation presented a fair picture to the ESOP fiduciaries, to be "clearly erroneous."

As this Court has long recognized, it is the role of the trial court, as finder of fact, "[to] draw inferences, to weigh the evidence, and to declare the result." *Helvering v. National Grocery Co.,* 304 U.S. 282, 294, *reh'g denied,* 305 U.S. 669 (1938). A court of appeals may reject a trial court's findings "only if those findings are clearly erroneous." *Citibank, N.A. v. Wells Fargo Asia*

Ltd., 495 U.S. 660, 670 (1990).[5] Fair market value of a stock is a question of fact reviewable under the "clearly erroneous" standard. *Eyler,* 88 F.3d at 451.

Here, the trial court conducted a six-week inquiry into the facts underlying the Arthur Young valuation. After weighing the evidence, the trial court found that the discounts applied by Arthur Young were "appropriate, were not improper or excessive, and were adequately justified by Arthur Young and Company and by the expert testimony offered by Defendants." *Howard v. Shay,* No. CV 91-146DT, slip op. at ¶ 29 (C.D. Cal. Filed Oct. 3, 1993). The trial court also found that the Arthur Young valuation report and fairness opinion "presented a fair evaluation of the transaction in question to the plan fiduciaries." *Id.* at ¶ 33.

The appellate court manifestly disagreed with the trial court's evaluation of the factual evidence. However, absent a specific finding that the trial court's holdings were "clearly erroneous," the appellate court had no basis to reject the trial court's factual findings. In this respect, the appellate court's decision inappropriately usurped the fact finding role of the trial court.

Perhaps more critically, the appellate court failed to cite any other expert authority for its criticisms of the Arthur Young valuation. Although both parties presented expert testimony at trial, the appellate court did not refer to expert testimony submitted by the plan participants, nor did it address the particulars of the expert testimony offered by the ESOP fiduciaries. Instead, the appellate court appears to have decided on its own that Arthur Young's selected discounts were excessive, and

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[5] Federal Rule of Civil Procedure 52(a) specifically provides:

> Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.

that Arthur Young failed to provide adequate explanation for the assumptions and techniques it selected.

The valuation of stocks and other assets owned by ERISA plans is a complex process, requiring the expert selection and application of numerous assumptions. Appellate courts typically lack the expertise to determine independently whether appropriate techniques and assumptions underlie an expert valuation. The trial court's factual findings were based on expert evidence submitted at trial, and were not found by the appellate court to be clearly erroneous. If the appellate court's ruling is permitted to stand, it will set the precedent that an appellate court can summarily reject expert testimony that has been favorably evaluated by a trial court without reference to the underlying record or to other expert evidence. Such an outcome will reduce the value of expert testimony, and may disrupt the judicial system as trial courts attempt to determine what weight, if any, they are permitted to assign to expert testimony. We therefore urge the Court to grant certiorari, and to specifically overrule this aspect of the appellate court's decision.

CONCLUSION

For the foregoing reasons, the Academy respectfully requests that the Court grant certiorari to consider the aspects of the appellate court's decision that are addressed in this brief.

Respectfully submitted,

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